

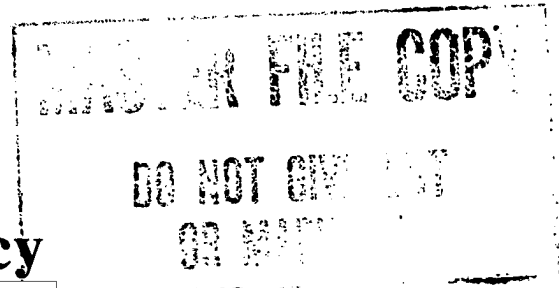


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The Economic Policy Process in China



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A Research Paper

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EA 83-10248
December 1983

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A Research Paper

This paper was prepared by [redacted] Office
of East Asian Analysis, with contributions from the
Office of Central Reference. [redacted]

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Comments and queries are welcome and may be
directed to the Chief, China Division, [redacted]

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The Economic Policy Process in China

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Key Judgments

*Information available
as of 30 November 1983
was used in this report.*

China's cumbersome policy process is the main obstacle to its economic stabilization efforts. Nearly five years after the leadership announced a three-year program to stabilize the economy—by cutting investment to reduce budget deficits and curb inflation—these problems are still basically unresolved:

- Investment continues to grow too rapidly.
- The 1983 budget deficit will be much higher than planned.
- Consumer prices continue to rise.

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Economic policy decisions—the most important of which are made by the Politburo—are often watered down and ambiguous. Policy options are limited by:

- The collective nature of high-level decisions.
- The state of political dynamics in the leadership.
- Preexisting economic policies—even those that have been publicly criticized.
- Identification of policies with individual leaders.
- Current definitions of ideological correctness.

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Policy implementation in the bureaucracy is undisciplined, in part because of ongoing economic management reforms. Interest groups beneath the Politburo level often have sufficient autonomy to make decisions that depart from central policy. We have identified six interest groups that play roles in the policymaking process and have at times blocked or delayed implementation of approved Politburo economic decisions: “superministries” with broad regulatory functions; line economic ministries; local governments; the military; local enterprises; and government economists.

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We believe the leadership is frustrated by the inefficiency of the policy-making process, but cannot agree on how to improve the existing system. Beijing's desire for management reform is balanced by the need to ensure centralized planning and control of China's economy. The leadership has rejected—probably out of fear of losing political control—proposals of those economists who favor radical reform. Beijing also has resisted calls by party conservatives for a return to rigid, top-down management of the economy, because such an admission of the failure of economic reforms would reduce confidence in Deng's entire reform program.

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In our view, Beijing will continue searching for solutions to economic problems, experimenting with reforms that do not further decentralize decisionmaking, seeking to enhance administrative controls without destroying local initiative, and publicly criticizing the policy process without developing effective measures to improve it. We believe that this approach, while politically safe, will do little either to improve the policy process or to solve China's economic problems.

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Table 1
China's Eight-Character Policy

Program	Purpose	Comment
Readjustment 调整	To stabilize the economy and put China on a path of balanced economic growth.	In most of the 1952-78 period, growth was usually led by—and priority in resource distribution given to—the heavy industry sector; a concomitant development was high rates of investment. Readjustment is aimed at correcting these biases, allowing more resources to flow into agriculture, light industry, and consumption. More recently, as industry and as the investment-consumption relationship have come more into balance, the goals of readjustment have altered; currently, readjustment focuses on channeling resources toward sectors constraining long-term growth—energy, transport, and education.
Reform 改革	To make economic management from top to bottom operate through material incentive systems and, thereby, to make the economy operate more efficiently; to make economic actors responsible for their actions and to compensate individuals and organizations according to performance, not to egalitarian principles.	In agriculture, the former top-down decisionmaking structure has been weakened deliberately and land turned over to households, which now have much more control over what is planted. In industry, reforms have centered on allowing enterprises to retain a share of profits and to give them some latitude in spending retained earnings. In addition, enterprises now have more authority in production and marketing decisions.
Consolidation 整顿	To ensure that enterprises are managed by technically competent and politically loyal individuals; furthermore, to correct lax discipline in enterprises throughout China by defining production tasks of employees at all levels.	In this respect, consolidation complements management reform in industry. A consolidation program, with deadlines for enterprises to have reorganized along specific guidelines, is administered by the State Economic Commission.
Improvement 提高	To raise productivity and overall management capabilities in the economy.	Most productivity indicators in China are below previous highs, and both reforms and consolidation also will help raise productivity. "Improvement" will be affected by educating individuals and by bringing in technology from abroad.

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The Economic Policy Process in China

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Since 1949 Chinese leaders have considered economic performance to be a key indicator of their success in governing. The watershed Third Plenum of 1978 elevated this issue to top priority, putting political campaigns in second place. This paper discusses economic policy formulation and implementation, especially critical issues today because Beijing has admitted publicly that devolution of decisionmaking authority is a chief cause of China's current economic problems.

The death of Mao Zedong permitted a significant change in the direction of economic policy. Deng Xiaoping and "reformist" elements in the party and government pushed hard to change the rigid and ineffective Maoist approach to the economy. In mid-1979 the "eight character" guiding policy (see table 1) for the 1980s was framed. The two most important components of this policy are structural adjustment and systemic reform. Both prescribe fundamental changes in the management of the economy, in the interpretation of Marxist ideology, and in the way economic decisions are made.

This paper describes the development of the economic decision making apparatus since 1978, using the 1980 decision on economic retrenchment to illustrate the process. This particular decision set is chosen because: (1) it was a crucial decision at that time and a highly controversial one; (2) information about the decision is relatively plentiful, permitting a description of the steps in the policymaking process and the interest groups that took part in it; and (3) the decision remains highly salient, as the problems it addressed have persisted.

The Uphill Road to Readjustment: 1978-81¹

The Third Plenum of the 11th Central Committee met in late 1978 and called a halt to the political campaign against Gang of Four followers set in train

in August 1977. Instead, the party announced that the focus of work would turn to economic modernization, and that China would experiment with economic reforms. In March 1979 a Politburo meeting further clarified economic policy and approved the "eight-character policy," key elements of which were to moderate excessive heavy industry growth, reduce investment spending, and curb inflation. Three days after the Politburo decision, a *People's Daily* editorial made public the main thrust of the readjustment decision. The policy was presented to a Central Committee meeting in April and formally ratified by the National People's Congress (NPC) in June.

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Readjustment did not come easily, however, and the ensuing year and a half proved that lower level decisions and actions can work against Politburo decisions. The State Planning and Economic Commissions continued to promote relatively high investment rates, despite the fact that cutting investment was a primary goal of readjustment.

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General economic performance worsened in 1980—as demonstrated by large budget deficits and serious inflation.

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¹ See appendix for a detailed discussion of the events summarized in this section.

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Figure 1: The "Promotion Group"
Usually included in the "promotion group" from left to right Li Xiannian (Politburo Standing Committee member responsible for the economy), Yu Qiuli (head of the State Planning Commission), Kang Shien (head of the State Economic Commission), and Gu Mu (head of the State Capital Construction Commission).

Central Documents Nos. 1 and 2 of 1981 and were accompanied by further press editorials. Finally, in February 1981 the retrenchment program was made explicit in a public speech on the revised 1981 economic plan by the new head of the State Planning Commission.

Elements of the Decisionmaking Process

Economic decision making in China involves all levels of the party and state bureaucracies. All important policies are developed and approved by the Politburo and particularly its Standing Committee. Often, an editorial in the party newspaper will explain the broad outlines of the Politburo decision. A Central Committee meeting sometimes formally endorses Politburo decisions on important policy questions. The decisions are passed down through layers of party and state bureaucracies in the form of numbered, normally classified, central documents. At the same time, the general character of such a document—usually not identified explicitly as such—often is publicized widely in the press. Policy decisions are then often incorporated in an economic plan document approved pro forma by the National People's Congress or its Standing Committee, whereupon implementation details are passed down through the remaining layers of bureaucracy to the producing units.

In a process similar to that in 1979, an early December 1980 *People's Daily* editorial disclosed the general thrust of the readjustment program approved at the 28 November Politburo meeting. The four important economic speeches at the Central Committee work conference were released to the party rank and file as

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Figure 2: The "Readjustment Group"

Usually included in the "readjustment group" are from left to right: Chen Yun (an authoritative economic leader rehabilitated after the Cultural Revolution and newly reinstalled as a member of the Politburo Standing Committee), Zhao Ziyang (then First Secretary of Sichuan Province and soon to become Premier), Wan Li (then First Secretary of Anhui Province and soon to be elevated to Vice Premier), and Yao Yilin (an associate of Chen's from the 1950s who was soon to replace Yu Qiuli as State Planning Commission chief).

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This is, of course, a great oversimplification of the process. A high-level policy choice does not work its way effortlessly down through a disciplined bureaucracy to unimpeded implementation at the lowest administrative levels. The formulation and implementation of economic policies are the result of a confluence of separate decisions made by interest groups throughout the system: from Politburo decisions, through implementing choices made by ministries and local governments, down to specific decisions made by producers. Because each of these groups has a measure of autonomy, the action that actually emerges at the end of the process frequently differs from the policy articulated at the beginning.

- Preexisting economic policies restrict options. Although Beijing is adept at the redefinition required to make a new policy appear consistent with previous policies, some continuity must be maintained to avoid bureaucratic confusion.

- Identification of policies with individual leaders promotes policy rigidity. A leader will resist a policy change—even if clearly needed—that could be viewed as discrediting his leadership. The collective will resist changing a failed policy to avoid having to affix blame for it. Conversely, a workable policy may be scrapped if the leader associated with it comes under attack for other reasons.

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We believe a number of political factors in the system limit policy options³ at the top and influence the final policy choice:

- The state of political dynamics in the leadership may preclude selection of a particular policy. If the group of leaders backing a policy believes it cannot win support for that policy, it will not propose and lose but will criticize and seek to undermine alternatives.

- The existing definition of ideological correctness may proscribe certain policy options or narrow the range of choices. Although the post-Mao leadership has demonstrated some flexibility in this regard, all policies must be defensible on ideological grounds.

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³ Other factors—such as information constraints and real resource constraints—also limit options, but discussion of these is beyond the scope of this paper.

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As these factors suggest, there is a nonconfrontational, collective character to economic decision making in China. An important step in the decisionmaking process is the jockeying to win organizational allies and co-opt opponents on a particular issue. Understanding the tactics involved in this process—and we shall treat these at some length below—is key to understanding Chinese economic decision making.

Finally, an important characteristic of the decision-making process is *guanxi*, or personal relationships. Although something comparable operates in every political system, personal relationships are critical in the Chinese system. In addition to formal channels for articulating policy preferences, individuals and groups exploit interpersonal relationships to influence decisions. A leader's *guanxi* very often determines the support he can mobilize behind his policy. The most effective administrators are those who have good connections up through the Politburo—to influence decisions—and down through the bureaucracy—to influence implementation. Not only is *guanxi* often the basis for advancement in a system that has not institutionalized performance-based promotions, but—in this nonmarket economy—*guanxi* between patrons and clients is a key element in resource allocation.

Interest Groups: Roles and Responsibilities

Six interest groups take part in the economic decision making process below the Politburo level:

- Superministries.
- Line ministries.
- Military establishment.
- Local governments.
- Enterprises.
- Think tanks.

Each group has a distinct role and set of responsibilities in the policy formulation and implementation process. These are not, however, so clearly delineated that they remain static. Subsets of some of the groups, in fact, contend with one another for influence, often to affect resource allocation. This is especially true as we move further along in the decisionmaking process, toward implementation.

Superministries

China's State Council, the supreme government body, currently consists of the premier, four vice premiers, 10 state councilors, and the heads of 45 ministry-level organizations. Of the latter, the State Planning Commission, the State Economic Commission, and the Ministry of Finance are the most important economic organizations. (Prior to its abolition in early 1982, the State Capital Construction Commission would have been included in this list of superministries.) These three superministries advise the State Council and the party on high-level policy issues, as well as initiate and pass midlevel policy recommendations to the State Council for its approval.

The State Planning Commission (SPC) is the most important of the three: it is responsible for drawing up and coordinating economic plans—both annual and longer term plans. Among the 20-odd economic ministries in the State Council, the SPC has no direct bureaucratic control over the others, but its structure (see table 2) demonstrates the all-encompassing nature of its coordination role. The head of the SPC has typically been a vice premier of the State Council with correspondingly high party position.⁴ His prominence is underscored by his delivery of a highly publicized address on the economic plan at each year's NPC session.

The SPC, in addition to its functional structure at the central level, has bureaus in each provincial capital. Planning organizations at provincial and lower levels are directly subordinate to the SPC, but have their closest working relationships with the local government to which they are attached. Consequently, local planning commissions tend to become clientistic. Given this structure and its responsibilities, we believe the SPC tends to favor relative centralization of decision-making authority and wants to have enough authority at its disposal to ensure that its decisions are carried out. The SPC tends to push ministries and provinces to perform beyond the limits they claim they can

⁴ Yao Yilin, head of the SPC from mid-1980 until mid-1983, was a vice premier and also sat on the party Secretariat. His replacement, Song Ping, was given the lower rank of state councilor.

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Table 2
Bureaus and Departments
Under the Superministries

State Planning Commission	State Economic Commission	Ministry of Finance
<ul style="list-style-type: none">• General Planning• Agriculture, Forestry• Light Industry, Textiles• Fuel and Power• Machinery Industry• Raw Materials• Defense Industry• Communications, Transport• Capital Construction• Finance and Trade• Technology, Health, Education, and Culture• Import, Export• Foreign Affairs	<ul style="list-style-type: none">• Production Coordination• Agriculture• Light Industry• Heavy Industry• Energy Management• Machinery and Electronics• Communications, Transport• Import, Export• Economic Laws• Enterprise Management• Technology Transfer• Foreign Affairs	<ul style="list-style-type: none">• Budget• General Taxation• Accounting• Agriculture• Industry, Communications• Capital Construction• Defense• External Financial Relations• Foreign Taxation• Offshore Oil Taxation• Technology• Quality Control• Foreign Affairs

attain. This is expected in a system in which all organizations set low performance criteria so that they can show results beyond targets. [redacted]

The State Economic Commission (SEC) is charged by the State Council with implementing and monitoring the annual economic plan. Through the year, the SEC convenes regular national meetings on economic performance, summarizing trends and providing guidance on problem areas that jeopardize fulfillment of the annual plan. Like the SPC, the SEC has branch organizations in every province. Prior to 1982 the SEC was responsible only for industry and communications; in 1982 government reorganization added agriculture and investment to the SEC portfolio, significantly expanding its oversight authority (see table 2). The SEC works closely with the SPC, both in formulating annual plans and in overseeing implementation. In some respects, the SEC is executive to the SPC's legislature, although many of their functions overlap. The two organizations, for example, share one foreign affairs office in their dealings with foreign delegations. [redacted]

Heads of the SEC typically have held high government posts: Zhang Jingfu, the current chief, is a state councilor. His predecessor, Yuan Baohua,⁵ remains a vice-minister of the SEC and devotes his time to China's enterprise management reform program, another function of the SEC. The SEC's economic reform oversight function is interesting because the decentralizing character of these reforms conflicts with the natural tendency of the SEC—like the SPC—to maintain its own influence levers in a more centralized economic system. [redacted]

The Ministry of Finance (MOF), the third of the superministries, is a combination tax collector and

⁵ Yuan replaced Kang Shien in 1980, following Kang's "demerit" for the Bohai oil rig coverup (see appendix). Kang's expertise and continuing political influence are evident in his remaining a state councilor. [redacted]

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fund dispenser.⁶ Through the consolidated state budget,⁷ the MOF takes in—through profit remittances and taxes—one-fourth to one-third of China’s national product. Budget outlays redistribute these funds and are the most important determinant of the allocation of China’s resources. The MOF works closely with the SPC in formulating economic plans and with the SEC in monitoring performance, but the SPC and MOF tend to disagree. Chinese fiscal policy is generally conservative, and the MOF’s preference for balanced or surplus budgets has often conflicted with the SPC’s willingness to spend more to generate growth. Still, the SPC view generally will prevail because of its bureaucratic superiority over the MOF. []

The MOF chief in recent years has been of slightly lower political stature than the heads of the other two superministries, but the current head, Wang Bing-qian, is—like his two counterparts—a state councilor. Like the SEC and SPC, the MOF has a bureaucratic structure that extends down through local governments. []

Beginning in 1980, fiscal reforms greatly increased provincial revenue but reduced the central government’s ability to control fiscal affairs. In the 1980-82 period it appeared that local government branches of the MOF were less responsive to the ministry than they were to provincial governments. We believe, therefore, that the MOF has joined the SPC and SEC in calling for greater centralization of economic policy making. []

Line Ministries

The line economic ministries (see table 3) comprise 20-odd economic ministries and commissions with much more specific interests than the SPC, SEC, and MOF. They are tasked with directing production of individual commodity lines or with some aspect of marketing that output. It is the coordination of the individual activities of the line ministries that makes up the work of the SPC and SEC; their finances are

⁶ Although not a bureaucratic equal of the SPC and SEC, the MOF is more important than any other economic line ministry. []
⁷ China’s state budget includes the budgets of the central government and the budgets of the provinces. In recent years, economic reforms have decentralized financial authority to a point that significant funds are not controlled by the state budget. []

Table 3
Economic Line Ministries of the State Council

Agriculture, Animal Husbandry, and Fishery
Aviation Industry
Chemical Industry
Coal Industry
Commerce
Communications
Electronics Industry
Foreign Economic Relations and Trade
Forestry
Geology and Minerals
Light Industry
Machine-Building Industry
Metallurgical Industry
Nuclear Industry
Ordnance Industry
Petroleum Industry
Railways
Space Industry
Textile Industry
Urban and Rural Construction and Environmental Protection
Water Resources and Electrical Power
People’s Bank of China

overseen by the MOF. As is the case with the superministries, each line ministry has provincial bureaus and subprovincial offices. []

A ministry’s bureaucratic responsibilities are dual. One is to coordinate the activities of its subordinate local offices and to act as their representative in Beijing. Local offices, however, often are more interested in local prerogatives than in carrying out line ministry directives. Thus, we believe organizational discipline is not strong. The second task is to oversee the activities of those factories that are “ministry managed,” just as the ministry’s local offices manage the remainder of the enterprises in that sector. Enterprises under ministry management are typically the largest, though not always the most productive. The complexities of this bureaucratic structure make top-down control hard to maintain and obscure our view of actual paths of influence. []

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In addition to these oversight responsibilities, the ministry acts as spokesman for the entire sector in national policy and budget deliberations. Each ministry seeks to influence general economic policy and the budget, to maximize resources allocated to its sector.⁸

China's economic policies over the past 30 years have produced some predictable coalitions among the line ministries, and these coalitions are better able to influence deliberations on larger policy issues. China's pre-1978 predilection for a Stalinist development strategy favoring heavy industry naturally conferred influence on individuals in the steel, petroleum, machine-building, and other producer goods production ministries. Leaders of some of these ministries—particularly petroleum—rose to higher positions in the superministries and the State Council, perpetuating policies that benefited their power bases. However, the 1981 retrenchment downplayed heavy industry and was accompanied by the demotion of some heavy industry proponents from the highest state and party organs.

Local Governments

Each of China's 29 provinces, autonomous regions, and central municipalities is a bureaucratic microcosm of the central government (see table 4). Individually larger than most nations, the provinces vary greatly in size, population, resources, agricultural and industrial productivity, infrastructure development, and reliance on central financial support. Traditionally, the provinces have been the key point at which national economic guidelines are translated into workable policies for local implementation and have exercised considerable autonomy in economic policy making. Ever since the early 1950s there have been serious disagreements within the Communist Party over the degree of economic authority to be exercised by provincial governments. The argument persists to this day, with reformers (some of whom are former provincial leaders) arguing publicly that too much central

⁸ The Ministry of Metallurgical Industry (MMI) is a useful example. MMI production—particularly steel—was for most of the past 30 years regarded by the leadership as a leading indicator of economic performance. General economic policies emphasized steel production, and close ties between MMI leaders and the higher leadership ensured the sector priority in investment and other resources.

Table 4
Economic Bureaus of the
Liaoning Provincial People's Government

Planning
Economic
Finance
Agricultural and Animal Husbandry
Aquatic Products
Commerce
Communications
First Light Industry
Foreign Trade
Forestry
Grain
Machine Industry
Metallurgical Industry
Price
Second Light Industry
Statistics
Material Supply
Textile Industry
Urban and Rural Construction and Environmental Protection
Water Resources and Electrical Power

control over economic decision making has brought stagnation and waste to China's economy, while conservatives claim that localities make unwise economic decisions.⁹

In addition to maximizing their decisionmaking authority and developing their "comparative advantages" in agriculture, industry, resource development, and foreign trade, provincial governments vie with

⁹ Two post-1979 programs have substantially increased provincial authority. In 1980 Beijing initiated a revenue-sharing program with the provinces that earmarked for provincial coffers all revenues from locally managed enterprises. At the same time, Beijing encouraged each province to "develop its comparative advantage." The provinces have made the most of these programs and have pushed local self-interest to a degree Beijing now finds unacceptable. In 1981 and 1982 the central government had to borrow several billion yuan from provincial governments, and Beijing consequently reversed the revenue-sharing rules early this year.

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each other for access to central funds. Some poorer provinces in the interior have their budgets subsidized by the central government, using revenues generated by other provinces. Nonsubsidized entities, such as Shanghai, have lobbied since 1978 for relief from the burden of supporting deficit provinces, according to diplomatic sources. Conversely, poorer provinces would not be likely, we believe, to actively support policies that channel more central resources into already developed provinces. []

Provincial government influence in economic policy deliberations depends in large measure on *guanxi*, or the personal relationships between local bureaucrats and their patrons in Beijing. Deng and his party reformers have seemed especially reliant on provincial support. We believe that a leader like Deng Xiaoping will use his support from provincial leaders to overcome resistance to his ideas by other Politburo leaders. To some extent, however, local expectations may exceed the actual influence the province has in Beijing. [] a speech to party cadre discusses complaints by Sichuan officials that Premier Zhao Ziyang, after leaving that province for Beijing, no longer "speaks the Sichuan dialect." []

In addition to having some control over local finances, Beijing has methods of guiding provincial economic decisions. One such device is Beijing's influence on local governments through the party apparatus. Another is Beijing's decisions on economic infrastructure: for example, Beijing can apply leverage on a province by threatening to divert energy resources elsewhere. []

Still, Beijing's need for the support of the local governments to carry out central policy gives the provinces a certain amount of leverage. A provincial government that takes immediate and effective steps to implement the spirit and letter of central directives will gain favor in the eyes of those in Beijing who initiated the policy. []

Military Establishment

Although not concerned with day-to-day economic issues, the People's Liberation Army (PLA) has an important place in the economic decision making process. China's military-industrial complex is extensive, with hundreds of thousands of workers in thousands of enterprises throughout the country. In the

past few years, the PLA has received 15 to 20 percent of publicly announced budget funds (the actual figure is probably much higher). Moreover, several of the line ministries are primarily defense-related (most of the machine-building industries, for example) or have extensive production relationships with the military (such as the Ministry of Metallurgical Industry). The PLA's General Logistics Department also runs a large number of its own factories. []

In addition to these economic equities, the PLA has good *guanxi* in the Politburo, where much economic policy is made. Senior military officers constitute nearly one-third of the membership of the Politburo, and several are considered to have regular access to Deng Xiaoping. The PLA cannot, however, dictate economic policy, or even alter decisions in its own favor against strong opposition by economic leaders. For example, the military budget has been cut in three of the last four years, and although some senior officers have grumbled publicly, none have tried to reverse the decisions, as far as we know. However, the PLA does operate as a pressure group on economic policy questions, using its access, bureaucracy, and media to affect outcomes. []

Generally, the PLA leadership is interested in maintaining policy interest in—as well as state investment in—military modernization. Although most military officers subscribe to the need to subordinate military modernization to overall economic development, they are nonetheless anxious to make certain that the PLA gets its fair share of research and development funds, capital construction outlays, and Western technological know-how and equipment. The high command seems reconciled to the need to share military production skills, research facilities, and factory lines with civilian industry—and indeed military plants produce civilian goods—but it also seeks to ensure that dual use in no way reduces or deteriorates the productive capabilities of the military plants. []

Enterprises

At the bottom of the economic hierarchy are China's enterprises, both urban and rural. Since 1978—and particularly since 1982—important organizational

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changes have taken place in the countryside. "Production responsibility systems," as the rural management reforms are called, have turned effective control of a large part of China's farmland over to peasant households.¹⁰ By 1982 China reported that 90 percent of peasant households were directly responsible for individually managing an assigned plot of land. The commune-brigade-team structure remains in place but is much less the dictatorial top-down management system it was prior to 1978. Commune reforms are continuing. []

China's nonagricultural enterprises number about 400,000, divided mainly into state-owned enterprises and collective enterprises.¹¹ The former are government owned and managed, while the latter nominally are managed by their workers. The practical distinction is that state-sector enterprises remit most of their profits to the government, while most collective enterprises pay taxes to the government and retain whatever is left as profit. Collective enterprises generally are responsible for making ends meet and pay their own investment costs from retained earnings; state enterprise costs and investment are handled by the government. []

As noted earlier, state-owned enterprises are subordinate either to the central government or to provincial governments. Those under the central government answer to line ministries and—since the fiscal reforms of 1980—remit their earnings to the central budget. Enterprises managed by local governments are subordinate to functional bureaus—analogueous to the line ministries—at the provincial level or below and contribute to local revenues. []

Economic management reforms since 1978 have given enterprise managers much more control over their own finances than at any time in the past 30 years. The volume of retained earnings has nearly doubled and now is equivalent to over half of annual consolidated state budget revenues. China's enterprises are

¹¹ A minuscule private sector has reappeared following 1978 economic reforms, but still accounts for less than 2 percent of the nonagricultural labor force. []

by no means free agents—for example, the government sets most prices—but this increase in discretionary finances has strengthened their authority. []

China's enterprises have reacted to the devolution of authority—still primarily financial—as would be expected of rational economic actors. Enterprise managers seek to maximize the profits they retain and use these earnings to pay worker bonuses and construct new facilities. A major problem the government now faces is that China's legal and oversight structure is incomplete and enterprises can easily circumvent rules. Discipline through the system down to the enterprise level is so lax that government has found it nearly impossible to control local investment activity or impose fiscal restraint. []

Think Tanks: The Economists

The government has encouraged the participation of intellectuals in China's search for answers to its economic problems. Economists across the country, in central government organizations and research institutes, and in university economics departments have taken up the challenge to find solutions. The most influential economists are all rather old and steeped in the socialist economic theories of the 1950s, but they have responded enthusiastically to the regime's call. []

The State Council's Finance and Economic Commission (founded in March 1979) set up four working groups to research and propose solutions to economic problems. Between July 1980 and July 1981, as an outgrowth of this initial research effort, four "economic research centers" were set up by the State Council. China's most prominent economists were brought in to run the centers. For example, the State Council Economic Research Center was headed by Xue Muqiao and Ma Hong and was charged with carrying out research on economic questions proposed by the Central Committee and the State Council, with keeping the party and government informed of important trends in the economy, and with coordinating the efforts of other research organizations. Immediately after the December 1980 work conference on

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readjustment, a forum was convened at which China's best known economists praised retrenchment. Although Beijing's decision to readjust the economy had already been made, the economists discussed the effects of readjustment and debated scenarios for economic development [redacted]

As a group, the think tank economists have more experience in theoretical debate than in actual management. Some have few ideological compunctions about proposing nonsocialist solutions to economic problems. In 1979 and 1980, during the first relatively free economic debates in nearly 15 years, some economists argued openly for radical changes in management that borrowed heavily from capitalist practice. The economists by and large have supported policies that the "readjustment group" proposed: cut investment spending, improve living standards, expand light industry, and develop export markets. In fact, Xue Muqiao—a leading reform economist—was widely acknowledged to be Zhao Ziyang's personal adviser on economic questions after Zhao moved from Sichuan to the central government in 1980. [redacted]

China's economists enter the policymaking process in several ways. The most clear-cut influence they have on decisionmaking is through position papers they prepare at the behest of senior leaders. Economists also initiate policy proposals, although these will not go far unless they gain official sponsorship.¹² Once a policy is decided, economists are called on by the government to publish essays in the media supporting the policy. During policy implementation, academic organizations convene meetings to debate the theoretical and practical considerations of the policy line. They differ from some of the other interest groups, however, in that they do not seek to maximize the amount of resources they get, but the amount of influence they can bring to bear on the system. [redacted]

¹² A case in point is the policy proposals of the late Sun Yefang. Sun argued strongly in 1979-82 that enterprises not be permitted any authority to make new investment as they gained control over a portion of their profits. He stated that China's low depreciation rate should be raised, and that enterprises should be given authority to replace obsolete capital. Giving enterprises authority to conduct new investment would, according to Sun, lead to investment the government felt was low priority and that this, in time, would squeeze out high-priority government projects. Sun was proved correct, yet Beijing has moved only warily to recapture control over new investment in recent months. [redacted]

Policy Formulation and Implementation

The interest groups discussed above fall into two broad categories: those that have a direct role in policy formulation and implementation and those that are primarily implementers. Beijing's attempts in 1979 and 1980 to carry out a readjustment policy reveal much about the policy formulation and implementation processes, and about how interest groups interact in these two processes. Particularly interesting are the reasons that the 1979 and the 1980 policy decisions were different in form and implementation. [redacted]

Policy Formulation

On the surface, the 1979 and 1980 decisions to readjust were quite similar: the general call was for a cut in investment to permit improvements in living standards and for a reduction in the budget deficit to reduce inflationary pressures. In each case, the Politburo made a decision on readjustment that was ratified soon thereafter by a special meeting of the Central Committee. In both cases, the major leader behind readjustment—Chen Yun—addressed the Politburo and Central Committee on the need for readjustment, and he was backed up by Deng Xiaoping speeches supporting readjustment. [redacted]

In fact, however, there were important differences in the details of the policies and in their actual economic effects. At the 1979 party meetings there was only a general call for readjustment, and targets for investment and for steel production—the guidon for heavy industry—were lowered but by much less than the readjustment group had proposed. [redacted]

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Figure 3: The Politburo Standing Committee in March 1979
 From left to right: Chen Yun, Deng Xiaoping, Hua Guofeng, Ye Jianying, Li Xiannian, and Wang Dongxing.

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Figure 4: The Politburo Standing Committee in November 1980
 From left to right: Hua Guofeng, Li Xiannian, Hu Yaobang, Ye Jianying, Deng Xiaoping, Chen Yun, and Zhao Ziyang.

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Politburo and Central Committee speeches on readjustment contained specific figures that represented drastic cuts in investment and budget outlays. For example, the 1981 investment plan was set at 17 billion yuan, down sharply from the 1980 figure.

Xiaoping was not yet strong enough to move against him. By November 1980 Hua had relinquished his premiership and Deng was moving to have Hu Yaobang succeed Hua as Chairman.

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A third reason for the weaker policy in 1979 was that the "promotion group," whose members were the architects and supporters of the 10-year plan, was still in firm control of the SPC, SEC, and important ministries such as metallurgy and petroleum. As part of the effort in 1980 to push through a stronger retrenchment policy, the "readjustment group" was able to unseat the heads of the SPC and SEC and to discredit publicly the metallurgy and petroleum industries for pursuing inappropriate policies.¹³

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¹³ The Wuhan Steel Plant's new imported rolling mill and the nascent Baoshan Iron and Steel Company were criticized as costly, ill-conceived projects, and the petroleum ministry was brought to task for the disastrous sinking of the seagoing "Bohai 2" oil rig.

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A second reason for the differences in the two policies was the all-important state of leadership dynamics. In March 1979 Hua Guofeng was still Chairman of the party and Premier of the State Council, and Deng

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A fourth reason for the success of the 1980 policy outcome—one that ties in with some of the other points above—is that in 1980 the “readjustment group” was able to shape the debate in such a way that opponents were unable to argue effectively. Opponents of a strong readjustment had advanced the argument that the primary reason for the failure of the watered-down 1979 readjustment was that management reforms—called for by Deng—had conflicted with readjustment goals. Deng countered that the main cause of China’s economic problems was “leftist”¹⁴ views of economic managers, from central government leaders on down through the ranks. The debate was confined to “leftism” and consequently the “promotion group” was blamed for the failure of readjustment. []

Policy Implementation

As we have noted earlier, China’s economic policy implementation process cannot be viewed as a passive one wherein subordinate entities obediently carry out instructions from superior organizations. This has been particularly true since 1979, when Beijing began experimenting with systemic reform by devolving economic management authority not only to provincial governments but also to individual enterprises. []

From the standpoint of implementation, one important distinction between the 1979 and 1980 decisions was that readjustment opponents in 1979 took steps to block follow-on readjustment decisions. []

[] the SPC and SEC allied with certain heavy-industry line ministries to prevent resources from going to light industry. Thus, the SPC and SEC not only can influence the policy formulation process through backers on the Politburo but also can affect implementation. By late 1980 the leaderships of the SPC, SEC, and heavy-industry ministries were “readjusted” to ensure they would implement Politburo policy. The MOF—which had supported retrenchment but was unable in 1979-80 to hold the line on budget outlays—was strengthened in 1981 and successfully implemented a sharply reduced budget. []

“Leftist” economic thinking was defined as seeking high rates of economic growth through high investment and rapid growth of heavy industry, thereby ignoring improvements in consumption. []

The military establishment and the provinces contributed to the unsuccessful implementation of both the 1979 and the 1980 readjustment decisions. The military overspent its budget in 1979 and 1980, although this was attributed to the 1979 war with Vietnam. The provinces, meanwhile, took advantage of the revenue-sharing system initiated in 1980 and invested heavily in capital construction projects of marginal utility. Despite approval of a tougher readjustment policy, the military again overspent in 1981 and was itself responsible for nearly two-thirds of the deficit in what was to have been a balanced budget. The provinces continued to invest in low-priority projects, using funds over which Beijing had no control. The MOF reported that, although 1981 state budget investment was only slightly over target, investment outside the budget—including spending from provincial finances—overshot the plan by nearly 80 percent. []

The autonomy granted to China’s enterprises in the post-1978 period has meant that, even when the “readjustment group” in late 1980 was able to gain Politburo approval and ministerial cooperation for a drastic retrenchment, enterprises were able to virtually ignore the policy and pursue their own self-interest. Nonbudget investment rose in 1981, not only from retained enterprise earnings but also from bank loans to enterprises, and exceeded the plan by a wide margin in both cases. []

Consequently, the 1981 retrenchment was successful compared with the abortive effort of 1979-80, but implementation decisions by lower level interest groups still prevented as effective a program as the framers desired. The ability of interest groups to obstruct policy performance continues to this day. []

Beijing’s Search for a Decisionmaking Model

As the foregoing suggests, although policymaking is the province of party leadership caucuses, policy effectiveness has been weakened by decisions made by certain interest groups in the economic bureaucracy. []

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This lack of discipline—or lack of control—in the system is, in our view, the most visible characteristic of the economic policy process. And it is a characteristic that has been of the greatest concern to the economic leadership for the past five years. []

Beijing also seems to have difficulty in coordinating individual policies. The two policy initiatives of readjustment and reform often have conflicted with each other. Particularly, we believe the authority-dispersing effects of reform measures have undercut seriously the government's ability to achieve economic stabilization through readjustment. The incompatibility of readjustment and reform, already evident in 1980, has worsened in the ensuing three years. In fact, after relatively stable economic performance in 1981, the same problems that plagued the economy in 1979-80 resurfaced in 1982 and persisted in 1983.¹⁵ []

The purpose of the systemic reforms Beijing initiated in 1979 is to improve the economic management process. The reformers believe that enterprise managers should have more latitude to make decisions and should bear responsibility for errors as well as success. A major problem with the reforms has been that while authority has been decentralized, accountability has not. Beijing's dilemma is how to regain control over macroeconomic policy levers without seriously damaging the reform program. []

The political implications of the current situation are complex. We believe conservative opponents of economic management reform will point to the worsening economic situation and the inability of government to implement successful stabilization policies as evidence that the reform program has caused more problems than it solved. Opponents may also claim that decentralization of decisionmaking authority has led to an increase in corruption—so-called economic crimes. In our view, the recent campaign against “spiritual pollution”—aimed at eradicating “bourgeois” ideas in the party—is another manifestation of the struggle over reform in China. []

¹⁵ By stability, we mean lower investment rates, an improvement in the budget position, and a slowing in inflationary money creation. In 1983, investment growth is too rapid, the budget deficit promises to be the highest in three years, and money supply growth is at the fastest pace since 1980. Only severe measures in the final months of 1983 may restabilize the economy. []

We believe Beijing has three broad options with respect to the economic decision making process in the coming years:

- *At one extreme, Beijing could accelerate the reform process.* This would require price reforms without which the reform package itself—the Chinese admit—is doomed to failure. Beijing also would have to develop better macroeconomic control mechanisms in order to ensure some degree of control over the economy. This position has been cautiously advocated by some of the think tank economists. 25X1
- *At the other, Beijing could abandon management reforms and concentrate central control on economic stabilization.* This would amount to a return to the top-down Stalinist model of management of 1950s China. We believe that, despite five years of criticism of this model, it is still favored by some middle-level officials in some ministries, provinces, and the PLA. 25X1
- *Between these two extremes, the regime could continue “groping” for solutions—as the Chinese say.* This would mean a continuation of many of the reforms already initiated and successful, particularly those in agriculture. It also would mean a marked slowdown in the overall reform process and perhaps a recision of some reforms that have decentralized too far. We would expect that any new reform initiatives would focus on recentralizing economic decision making. At the same time, Beijing would have to continue issuing edicts aimed at correcting the unwanted side effects of reform that have undercut the stabilization effort. [] 25X1

In our view, the first option is risky, because—in the absence of a carefully constructed reform program—rapid change could cause further confusion and undercut party and government control of macroeconomic policy, especially in the short to medium term. The second is unlikely, in our view, because management reform is an important political commitment of 25X1

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the current government. Abandoning it would almost certainly call into question the remainder of Deng's programs. Either of these options would significantly alter the policy process.

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The third option, we believe, is most likely, and this means that the convoluted process of policy formulation and implementation will remain essentially unchanged. And this option—politically the least risky from Beijing's standpoint—virtually ensures that Beijing's current problems controlling the economy will continue for the foreseeable future

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Appendix

A Chronology of Readjustment Policy

In February 1981 the National People's Congress (NPC) Standing Committee formally approved a drastic revision to the 1981 economic plan adopted by the full NPC the preceding September. This event was the capstone to events set in train at the Third Plenum in late 1978. []

Late 1978 to Mid-1980: An Abortive Attempt

Following the Third Plenum of the 11th Central Committee in late 1978, a March 1979 Politburo meeting established a broad economic policy line for the ensuing years. The Third Plenum had reinstalled on the Politburo Standing Committee Chen Yun, China's economic crisis manager in the early 1960s during the recovery from the disastrous Great Leap Forward. According to Deng Xiaoping, speaking in late 1980, Chen was brought back to take charge of the nation's finance and economic work. This plenum also called for an end to political activity against Gang of Four followers and directed the country to turn its collective attention to economic tasks. At the 1979 Politburo meeting, Chen Yun defined what the economic tasks for the coming few years would be and summarized them in the "eight-character policy": readjustment, reform, consolidation, and improvement. (Chen had coined a similar "eight-character policy" in the early 1960s containing readjustment as its primary element.) []



Chen Yun (left) and Zhao Ziyang in 1982 []

The major policy-setting address at the April 1979 Central Committee conference was delivered by Li Xiannian, who outlined specific readjustment goals for the 1979-81 period (see inset). Readjustment was explicitly aimed at redressing sectoral imbalances in the economy and fostering balanced growth for the foreseeable future. []

The "eight-character policy" was announced with fanfare at the June 1979 second Session of the fifth NPC, in Premier Hua Guofeng's government work report. Between mid-1979 and mid-1980, however, it was not implemented to the satisfaction of Chen Yun.

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**Summary of Chen Yun's 21 March 1979
Politburo Speech**

Chen's speech stressed that China had to plan for a more reasonable economic growth rate and that it should also seek balanced growth rather than pushing for rapid growth of steel and other heavy industry. The speech made four points:

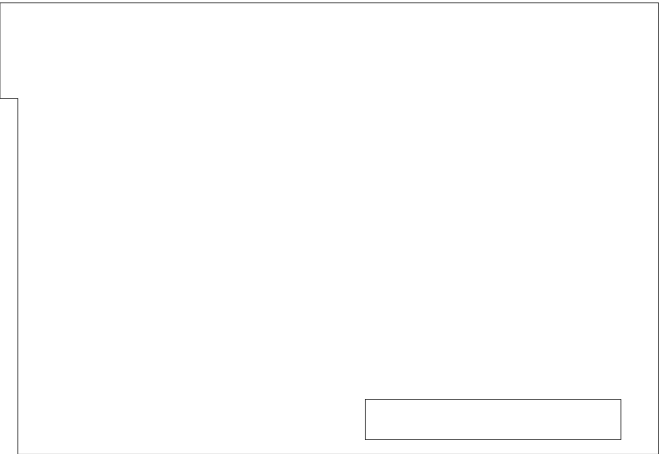
- To plan effectively, one must understand China's basic conditions: the country is poor and backward, and many are hungry.*
- Balanced economic growth will give us the fastest economic growth rate.*
- We must spend two to three years readjusting the imbalances in the economy; to do this we must cut investment.*
- We should not set our steel output target too high.*

[redacted]



Deng Xiaoping [redacted]

**Late 1980 to Early 1981:
Successful Readjustment**



Yao's speech on the economic plan was, we believe, the speech that Yu Qiuli would have delivered had he remained head of the SPC. The key indication that this is true is that Chen Yun, in a September 1979 speech to the State Council Finance and Economic Committee, noted that two proposals had been put forward for an investment figure for 1980. The higher of the two was proposed by the SPC—then headed by Yu—and the other, lower figure was put forward by the Ministry of Finance. Chen, without stating in his speech which of the two he favored, noted merely that the level of investment should be cut in 1980 from the

[redacted]

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**Summary of Li Xiannian's 5 April 1979
Central Committee Work Conference Speech**

Li's speech was considered by attendees to be the most important of the work conference speeches, because he laid out in detail the meaning of readjustment. The speech contained five sections:

- *Li described the economic situation at the time and explained why readjustment was necessary. He stated that relative priorities in the following areas had to be readjusted: agriculture versus industry, light versus heavy industry, electric power versus other industry, consumption versus accumulation.*
 - *Li explained, as Chen Yun had in March, that China's basic conditions of poverty and backwardness must be taken into account in the planning process.*
 - *Li enumerated the following 12 principles of readjustment:*
 - *Develop agriculture as a priority.*
 - *Develop light industry and textiles.*
 - *Of the heavy industries, focus on electric power, transportation, and building materials.*
 - *Keep energy development apace with industry.*
 - *Reduce investment spending.*
 - *Import capital carefully and only according to needs.*
 - *Expand exports.*
 - *Slowly adjust domestic prices.*
 - *Gradually solve unemployment problems.*
 - *Control population growth.*
 - *Improve living standards.*
 - *Improve planning work.*
 - *Li stressed the need to continue with enterprise consolidation, the program designed to upgrade factory management. In this way, China's enterprises should be able to raise output and at the same time raise efficiency.*
 - *Li addressed the second item in the eight-character-policy: reform. He said that the attitude toward reform must be positive, but that the reforms must proceed at a measured pace.*
-



Hua Guofeng

high level of 1979. Yao's August 1980 NPC economic speech called for precisely the level that the SPC had proposed nearly a year earlier. Thus Yao, who had only recently assumed command of the SPC, did not revise its proposals before delivering the speech.

During the August-September 1980 NPC, the Chinese press carried extensive coverage of remarks by NPC delegates on the state of the economy. Many of the remarks were critical of the government's conduct of the economy and called for a reduction in budget deficits, which were putting strong upward pressure on consumer prices. The deficits were linked, in many delegates' statements, with high spending on investment. We believe that the Deng Xiaoping-led government would not have countenanced such a public display of displeasure with the government unless Deng intended to use this criticism as a weapon against political opponents.

Just preceding the public attacks at the NPC on the government's—and, at least implicitly, Yu Qiuli's—conduct of the economy, another member of the “promotion group” was publicly criticized by the government. Kang Shien, head of the State Economic Commission since March 1978, was accorded a “demerit, first class” for the “Bohai 2 incident.” The State Council, in handing down this punishment to

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Kang, explicitly named him as culpable for the incident—which involved the coverup of a decision leading to the death of about 100 people on the “Bohai 2” offshore drilling rig—because he was the vice premier responsible for the petroleum industry. Kang did not immediately lose his job as Economic Commission head, but was replaced by his deputy, Yuan Baohua, in March 1981. A third member of the promotion group and head of the third of the three important economic commissions—the State Capital Construction Commission—was Vice Premier Gu Mu, who was also replaced in March 1981.

Gu effectively relinquished his control over the Commission sometime late in 1980.

nine Politburo meetings were held between 10 November and 5 December 1980 to discuss top-level personnel changes to be presented to the Sixth Plenum of the 11th Central Committee.

Deng Xiaoping gave a speech before an expanded Politburo meeting on 18 August 1980 in which he addressed the general topic of personnel changes.

following this August meeting, many cadre called for the resignation and self-criticism of Chairman Hua Guofeng. The nine Politburo meetings were held to extract a self-criticism from Hua. At the first of the meetings, Hua asked that he be replaced in all his party posts but did not make what the attendees felt was an adequate self-criticism until the final 5 December meeting. At that meeting, the Politburo accepted his resignation but agreed not to make it public until the Sixth Plenum, held in June 1981.

economic policy changes were not discussed at these Politburo meetings, but

Deng Xiaoping, Chen Yun, Li Xiannian, and probably Zhao Ziyang made speeches to an undisclosed group, perhaps an enlarged meeting of the Politburo. We have no documentary evidence of the contents of these speeches, but each of these leaders delivered addresses to the

Central Committee work conference that convened 16-25 December in Beijing and announced the decision to retrench in 1981.

Premier Zhao's work conference report (see inset) was explicitly delivered on behalf of the CFELG and contained the specific details of the 1981 retrenchment, ultimately made public by Vice Premier Yao two months later.

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*Summary of Chen Yun's 16 December 1980
Speech to the Central Committee Work Conference*

Chen's speech contained the following 14 points:

- *China must use foreign capital, but must do so carefully.*
- *Although the current economic situation in China is not bad, the leadership must be aware of the problems, particularly inflation. If inflation is not controlled, living standards will be affected and may lead to political instability.*
- *The economic reforms have had many positive effects on the country, but they have brought unwanted side effects, such as excessive investment spending.*
- *Although we continue to search for ways to allow rational economic principles to govern our actions, China is a planned economy and the government must have control over much of the economy.*
- *China must impose a price freeze for at least six months. To some people this seems like too much government intervention, but it is necessary.*
- *China must recentralize control over finances. Local governments must cut their expenditures and their fiscal surpluses must be turned over to the central government. The leadership will continue to look for ways to institute reforms, but reforms must be coordinated with the readjustment effort.*
- *Although the goal of socialist production is to improve living standards, China must raise standards only when economic conditions permit.*
- *Imported capital projects must be carefully scrutinized before China approves them. Experts should be involved in the process and all aspects of a problem considered.*
- *China must conserve foreign exchange. First, it must not allow so many delegations to go abroad. Second, it must ensure that Chinese exporters do not bid export prices down.*
- *Although China must encourage the production of nongrain crops, it should not allow this to reduce grain production.*
- *Because China's population is so large, it must be careful in examining the development models of other countries: they may not be applicable.*
- *In working toward the "four modernizations," China must exploit its current technology as much as possible. China will be able to learn from abroad, but there is a limit to this.*
- *The biggest problem in China's economic development over the past 30 years has been a "leftist" orientation to economic work, and this has come from "leftist" guidance from our leadership for all these years.*
- *Although there are certain aspects of readjustment that involve retrogression and a pulling back from some programs, China must do this because it will improve its performance in the future.*

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*Summary of Zhao Ziyang's 16 December 1980
Speech at the Central Committee Work Conference*

Zhao's speech was the most important of the meeting and he laid out specifics of the readjustment program for 1981. The address was divided into five sections:

- *First, Zhao detailed the reasons that a drastic retrenchment was necessary:*
 - *Although the economic situation is good in many ways, there are "potential dangers" in the economy. Large budget deficits have forced excessive currency creation, which has led to inflation. This probably will result in political destabilization if not checked.*
 - *"Leftist" economic thinking still exists, and has resulted in overspending on investment.*
 - *Consequently, after two years of readjustment, there is still no marked improvement in imbalances in the economy.*
 - *Each time readjustment has begun to take hold, there has been a turn for the better in the economy, followed by a resurgence of "leftism."*
- *The form of readjustment next year:*
 - *In line with directive of the Politburo Standing Committee, there are three basic tasks: balance the budget, stabilize credit to control currency supply, and stabilize commodity prices.*

— *Zhao here detailed budget items that would be cut and stated how much the cuts would be.*

— *Zhao also said that readjustment would last for the entire Sixth Five-Year Plan period (1981-85).*

- *Zhao hammered on the theme of centralization, stating that, as Deng Xiaoping had said, the only way to stabilize the economy was for the central government to recapture some of the authority it had decentralized. He also stated that the pace of economic reform would have to be slowed during the readjustment. Still, he said, some reforms that did not conflict with readjustment could be pursued.*
- *Zhao said that since the level of investment spending was to be cut, China had to rely on efficiency improvements for growth for the coming few years. This would be accomplished by carrying out enterprise consolidation (the third element of the eight-character policy).*
- *Finally, Zhao urged all Chinese to understand the current situation and the reasons that readjustment was required and exhorted everyone to pitch into the effort. He pointed out that the budget cuts would be severe, but that they were necessary.*

[REDACTED]

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Between January and the late February convening of the 17th Standing Committee of the Fifth NPC, Yao Yilin's Planning Commission presumably put the finishing touches on the readjusted 1981 economic plan and state budget. Premier Zhao had already provided the specific guidelines for the alterations in his December work conference address, but the two

months were apparently necessary to permit the Planning Commission to coordinate these changes with sectoral and provincial plans, most of which presumably required adjustments. [REDACTED]

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